

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING # 02-31**

**WARNING**

**Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.**

**SUBJECT**

Application of the venture capital fund exemption to Tennessee's franchise, excise taxes.

**SCOPE**

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the department by the taxpayer. The rulings herein are binding upon the Department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a revocation of the ruling must inure to the taxpayer's detriment.

**FACTS**

[THE TAXPAYER] is a Delaware limited partnership that will operate a small business investment company known as an SBIC, pursuant to a license granted by the United States Small Business Administration ("SBA"). The purpose of the Taxpayer will be to provide both "seed" and "equity expansion" capital to a number of technology-based, non-publicly traded businesses in Tennessee and surrounding states. The Taxpayer will be operated exclusively to buy, own and sell securities in non-publicly traded companies on its own behalf and not as a broker.

A flow chart attached as Exhibit 1 illustrates the ownership structure of the Taxpayer and its affiliates described below. The Taxpayer has [NUMBER] limited partners including the SBA. A schedule of the limited partners is attached as Exhibit 2. The sole general partner of the Taxpayer is [GENERAL PARTNER A]. The sole limited partner of [GENERAL PARTNER A] is [LIMITED PARTNER A] and the sole general partner of [GENERAL PARTNER A] is [GENERAL PARTNER B]. [CORPORATION A] is the sole shareholder of [GENERAL PARTNER B]. [CORPORATION A] is a non-profit subsidiary of [LIMITED PARTNER A], a Tennessee non-profit corporation.

[GENERAL PARTNER A] is a Delaware limited partnership. [GENERAL PARTNER A'S] sole purpose is to be the General Partner of the Taxpayer. [GENERAL PARTNER B] is the corporate general partner of [GENERAL PARTNER A]. [LIMITED PARTNER A] is the sole limited partner of [GENERAL PARTNER A]. The investment committee for [GENERAL PARTNER A] monitors the performance of the Taxpayer and is responsible for formulating the investment policy of the Taxpayer.

[GENERAL PARTNER B] is a Delaware corporation. The sole purpose of [GENERAL PARTNER B] is to govern the [GENERAL PARTNER A] limited partnership. [CORPORATION A] is the sole shareholder of [GENERAL PARTNER B].

[CORPORATION A], formerly [LIMITED PARTNER A] Finance Corporation, is a non-profit corporation exempt under Internal Revenue Code Section as a 501(a)(3) supporting organization to [LIMITED PARTNER A]. [CORPORATION A] is engaged in community development financing activities that provide debt and equity funding to start-up and early stage small businesses in [REGION]. [CORPORATION A] is the Investment Adviser/Manager of the Taxpayer through a written management services agreement and receives a fee from the Taxpayer for operational management services.

[LIMITED PARTNER A] is a non-profit corporation under Internal Revenue Code Section 501(c)(3) and headquartered in [CITY], Tennessee. The mission of [LIMITED PARTNER A] is to leverage the unique information technology resources in [AREA] Tennessee to incubate new business, create private sector jobs, and improve the prospects for future economic growth.

Exhibit 3 illustrates the overall management structure of the Taxpayer and its affiliates. A description of the Taxpayer's limited partners and their relationship, if any, to the Taxpayer and the Advisory Board, [GENERAL PARTNER A] and the Investment Committee, [GENERAL PARTNER B], [CORPORATION A], and [LIMITED PARTNER B] is presented in Exhibit 4.

The primary investor in the Taxpayer will be the SBA. The SBA will be investing approximately [AMOUNT], which represents [MORE THAN 50%] of the total capital to be invested in the Taxpayer. The SBA will license the Taxpayer as a SBIC, but the SBA is not related to nor affiliated with the Taxpayer, as those terms are defined by Tenn. Code Ann. § 67-4-2008(a)(5).

## QUESTION

Does the Taxpayer qualify as a venture capital fund exempt from Tennessee franchise, excise taxation under Tenn. Code Ann. §§ 67-4-2008(a)(5) and 67-4-2105(a)?

## RULING

Yes.

## ANALYSIS

Tenn. Code Ann. § 67-4-2008(5) provides that venture capital funds are exempt from the payment of excise tax if the fund meets the following parameters:

[it] is a limited liability company, a limited liability partnership, or limited partnership, formed and operated for the exclusive purpose of buying, holding and/or selling securities, including debt securities, primarily in non-publicly traded companies on its own behalf and not as a broker, and the capital of which fund is primarily derived from investments by entities and/or individuals which are neither related to nor affiliated with the fund. For purposes of this subdivision, the following provisions shall apply:

(A) I.R.C. Section 267(b) and (f) and any federal regulations applicable thereto, as they may be amended from time to time, shall be used to determine whether entities and/or individuals are “related”.

(B) “Affiliated” means entities that are part of an affiliated group as defined in I.R.C. Section 1504(a) and any applicable federal regulations thereto, as they may be amended from time to time.

(C) “Non-publicly traded companies” means any business entity that is not a “publicly traded company”, as defined by subdivision (E) below.

(D) “Primarily”, as used in this subdivision, means over fifty percent (50%).

(E) A “publicly traded company” is any company that is traded on:

(i) a national securities exchange registered under Section 6 of the Securities Exchange Act of 1934 or exempted from registration under such Act by 15 U.S.C. 78f because of the limited volume of transactions;

(ii) a foreign securities exchange operating under principles analogous to a national securities exchange;

(iii) a regional or local exchange;

(iv) an interdealer quotation system that regularly disseminates firm buy or sell quotations by identified brokers or dealers by electronic means or otherwise; or

(v) on a secondary market or the substantial equivalent thereof, if taking into account all of the facts and circumstances, the owners are readily able to buy, sell or exchange their ownership interest in a manner that is comparable, economically, to trading on an exchange.

Tenn. Code Ann. § 67-4-2008(5).

It is without issue that the Taxpayer satisfies the first criteria of exempt venture capital funds because it will do business in Tennessee as a Delaware limited partnership. Therefore, the Taxpayer will be considered as an exempt venture capital fund if (1) it is formed and operated for the exclusive purpose of trading in securities of primarily non-publicly traded companies on its own behalf, and (2) its capital is primarily derived from investments by entities and/or individuals that are neither related to nor affiliated with the fund.

The Taxpayer indicates that in providing “seed” and “equity expansion” capital to a number of technology-based, non-publicly traded businesses it will be operated exclusively to buy, own, and sell securities in non-publicly traded companies on its own behalf and not as a broker. Since the Taxpayer will limit its activities to those described, it will satisfy the criteria of buying, holding and/or selling securities, primarily in non-publicly traded companies on its own behalf. Therefore, the Taxpayer will satisfy the second requirement of exempt venture capital funds.

Finally, to be considered an exempt venture capital fund the Taxpayer’s capital must be “primarily derived from investments by individuals and/or entities which are neither related to nor affiliated with the fund.” Tenn. Code Ann. § 67-4-2008(5). The term “primarily” is defined to mean over fifty percent (50%). Tenn. Code Ann. § 67-4-2008(a)(5)(D). Furthermore, an entity or individual is related if it satisfies any of the relationships outlined in Internal Revenue Code § 267 (b) and (f), and an entity is “affiliated” if it is part of an affiliated group as defined in I.R.C. 1504(a). Tenn. Code Ann. § 67-4-2008(5)(A) and (B).

Since the SBA is investing [MORE THAN 50%] of the of the total capital invested in the Taxpayer, the Taxpayer’s capital is primarily derived from the SBA. The SBA is not related to the Taxpayer because Internal Revenue Code § 267 (b) and (f) does not include a governmental entity and a partnership as related persons. Furthermore, neither the individual investors nor the SBA are affiliated with the Taxpayer as contemplated by Tenn. Code Ann. § 67-4-2008(a)(5)(B) because they are not a part of the same affiliated group.

The Taxpayer satisfies all of the criteria set forth in Tenn. Code Ann. § 67-4-2008(5) and as a result is exempt from Tennessee excise taxation as a venture capital fund. Furthermore, since the Taxpayer is exempt from excise taxation, it will also be exempt from franchise taxation under Tenn. Code Ann. § 67-4-2105(a).

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APPROVED: Ruth E. Johnson  
Commissioner

DATE: 9-6-02